

Legislative Audit Division

State of Montana



Report to the Legislature

October 2006

Financial-Compliance Audit

For the Two Fiscal Years Ended June 30, 2006

Department of Revenue

This report contains seven recommendations to the department. Issues addressed in the report include:

- ▶ Financial Accountability
 - Reconciliation controls
 - Unrecorded revenue and expenditures
 - Debt collection program
- ▶ Improving tax compliance for:
 - Combined oil and gas severance taxes
 - Corporation license taxes
 - Individual income taxes
- ▶ Noncompliance with state statutes

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Findings and Recommendations

Improving Tax Compliance

The department is responsible for the administration and enforcement of many of the state's tax laws. We found the department could change procedures to improve taxpayer and department compliance with state tax laws related to combined oil and gas severance, corporation license, and individual income taxes.

Combined Oil and Gas Severance (COGS) Taxes

The department does not have adequate procedures to ensure COGS tax liabilities are reasonable for producers that are not the largest producers and to immediately estimate taxes for COGS nonfilers, as required by section 15-36-313(1), MCA.

Production and Sales Reporting Discrepancies

COGS collections were \$126.8 million and \$192.8 million in fiscal years 2004-05 and 2005-06, respectively. COGS producers are required to file and pay taxes, based on reported production and sales data, quarterly. The department's audit function provides a means for the department to examine taxpayers' financial records to determine whether they have accurately calculated and reported their tax liabilities. Only the largest producers, representing approximately 85 percent of total reported COGS tax revenue, receive audits that verify production and sales data.

The Board of Oil and Gas Conservation (BOGC) requires oil and gas producers to report production and sales data monthly. In the past, the department cross-matched data received with quarterly tax returns to the data provided to the BOGC and followed up large or unexpected differences through contact with the producer.

Department personnel indicated they do not currently have the staff resources to perform these procedures. Comparing tax return information to the BOGC data may help the department identify unreported COGS tax liabilities.

We compared production and sales data that six producers reported to the department through quarterly tax returns to the production and sales data those producers reported to the BOGC for the same period. We found discrepancies for three of the six producers tested: three discrepancies for gas and two for oil, ranging from 7 to 48 percent of the amounts reported to the department on tax returns. In

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all but one case, the producer reported higher oil and gas production data to the department than to the BOGC.

We also compared the department's listing of taxpayers by lease unit for the fourth quarter of 2005 to the BOGC's listing of operators by lease unit for October through December 2005. We compiled a partial list of the operators and leases that were on one listing but not on the other listing and asked department personnel to research these differences. They found four of the operators on the BOGC's listing that were not on the department's listing had not filed tax returns. They also found a fifth operator had not filed taxes for two lease units reported to the BOGC that were not reported to the department. Based on these results, department personnel indicated in June 2006 that they have started to perform this cross-match again.

Assessing COGS for Nonfilers

When COGS taxpayers fail to file taxes within the time required, the department is required by section 15-36-313(1), MCA, to ascertain the amount of oil and gas produced and sold during the quarter and each month of the quarter, immediately after the time for filing has expired. The department is also required to determine the average value of the oil and gas produced and sold, and to fix the amount of taxes due for the quarter.

In June 2006, the department was identifying, contacting, and estimating taxes for nonfilers for the quarter ended September 30, 2005. Department personnel stated they do not have the staff resources to estimate tax liabilities immediately after the time has expired. The department should work with the BOGC to develop procedures to facilitate efficient comparison of oil and gas production and sales information by operator and lease.

Recommendation #4

We recommend the department work with the Board of Oil and Gas Conservation to develop and implement procedures for cross-matching oil and gas production and sales data to ensure all oil and gas severance taxes owed are reported or assessed in accordance with state law.

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additional penalties only when it is very clear the taxpayer purposely failed to file a tax return or pay a tax when due. As a result, these units do not comply with the requirements of the additional penalties law.

Statutory Housekeeping

The following statutes affecting the department's operations are out of date.

Municipal Corporations

As discussed in our prior audit report, section 15-1-201(3), MCA, requires the department to collect information on expenditure of public funds for all purposes from officers of municipal corporations to assist the department in its work. Department personnel noted they no longer collect this information because it is not needed. We determined the department is in substantial compliance with section 15-1-201, MCA, but should seek legislation to amend this statute to reflect the current information needs of the department.

Statement of Coal Sales

Section 15-35-104, MCA, requires each coal mine operator to provide a statement of the tons of coal sold to each purchaser for the quarter. The department has not required coal mine operators to provide this statement for several years, because the tax is no longer based on this information. Therefore the forms and instructions provided by the department for coal taxes do not contain this requirement. The department should seek legislation to amend this statute to reflect its current information needs.

Recommendation #7

We recommend the department:

- A. Centrally assess cellular phone companies as required by section 15-23-101, MCA.**
- B. Implement procedures and administrative rules to provide consistency in assessing additional penalties for purposely failing to file or pay taxes when due, as required by sections 15-1-216(1)(b) and (1)(d), MCA.**
- C. Seek legislation to amend sections 15-1-201 and 15-35-104, MCA, to reflect the department's current information needs from municipal corporations and coal mine operators.**